ISLAMIC BANKING IN THAILAND: PROSPECTS AND CHALLENGES

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Thailand is a multi-religious country and Islam is the second largest religion with over six million followers. Majority of Muslims reside in the Southern Region of the country which is located at the Malaysian border. Hence, the population here is easily exposed and influenced by the Malaysian Islamic banking system. The Islamic banking system in Thailand first started when 'Islamic window' concept was introduced by Government Savings Bank in 1998. Similar concept was also implemented by the Bank for Agriculture and Agricultural Cooperatives in 1999 which was followed by the introduction of 'Islamic Branch' by Krung Thai Bank in 2001. The Islamic banking system gained more support from the government through the establishment of Islamic Bank of Thailand in 2003. Being relatively new, Islamic banking in Thailand faces many challenges. Among challenges highlighted in this paper are economic region, public acceptance, rules and regulations and infrastructure. The prospects of this new system as an alternative to the existing conventional banking system are also discussed.

1. Introduction

Thailand is a multi-religious country and Islam is the second largest religion with over six million followers. Majority of Muslims are populated in the province of Yala, Pattani, Narathiwat, Satun and Songkla. Since these provinces, located in the Southern Region, are situated adjacent to the Northern States of Malaysia, they are therefore easily exposed and influenced by the Malaysian Islamic banking system. The Islamic banking system in Thailand first started when the Government Savings Bank (GSB) introduced the 'Islamic window' concept in 1998. Similar method was also implemented by the Bank for Agriculture and Agricultural Cooperatives (BAAC) in 1999 and followed by the introduction of 'Islamic Branch' by Krung Thai Bank in 2001. The Islamic banking system expanded further when Islamic Bank of Thailand was established by the Thai government in 2003.

Since Islamic banking in Thailand is relatively new, it faces many challenges. Among these are economic region, public acceptance, rules and regulations, meeting public demand and infrastructure. Overcoming these challenges involves the hard works and diligent efforts from various parties. The main objective of this paper is to elaborate in detail those challenges and provide remedial solutions. This paper is divided into five sections. Section Two and Three provide an overview of the total banking system and the development of the Islamic banking system in Thailand, respectively. Section Four discusses the prospects and challenges of this new system as an alternative to the conventional system. Section Five provides the concluding remarks.

2. An Overview of the Banking System in Thailand

The banking system in Thailand started when British-owned Hong Kong and Shanghai Bank established its branch in 1888. It was followed six years later by the Chartered Bank in 1894, and the French bank, Banque de I' Indochine in 1897. Up until 1955, when the Thai Cabinet passed a resolution to restrict the approval of new banks, there were 12 foreign banks operating in Thailand. The main reason for these banks setting up branches in Thailand is to facilitate trading between their home country and Thailand. The first local commercial bank, Siam Commercial Bank (formerly known as Thai Commercial Bank) was established in 1906 (BOT; 1992: 174). Prior to this, the financial institutions in Thailand were pawnshops, which had been in operation since 1866.

The establishment of Siam Commercial Bank fuelled the incorporation of domestic banks led by Chinese traders and noblemen in the community. The founders and shareholders of these new banks were also shareholders of the Siam Commercial Bank. By the end of 2000, there were 34 commercial banks in Thailand, of which 13 were locally incorporated1[1] and 21 were branches of foreign banks (BOT; 2000: 2).

The current structure of financial institutions in Thailand is shown in Table 1. The classifications of these institutions are based on business activities and are supervised by different authorities. Generally, these institutions belong to two groups i.e. banking and non-banking institutions. Banking institutions include Bank of Thailand (BOT), commercial banks, International Banking Facilities (IBF), specialized banks (i.e. the Government Savings Bank (GSB), Bank for Agriculture and Agricultural Cooperatives (BAAC), EXIM Bank and the Government Housing Bank (GHB)). Non-banks financial institutions comprise of finance companies, finance and securities companies, Mutual Fund Management Companies, The Industrial Finance Corporation of Thailand, Small Industry Finance Corporation, Small Industry Credit Guarantee Corporation, Social Security Fund, credit foncier companies, life insurance companies, agricultural cooperatives, savings cooperatives, and pawn shops. In response to the Asian financial crisis in 1997, several new organizations have been set up as part of the financial sector restructuring effort, namely, the Financial Sector Restructuring Authority (FRA), the Radanasin Bank (RAB), the Asset Management Corporation (AMC), and the Property Loan Management Organization (PLMO). A brief of some of the important financial institutions in Thailand is as follow:

[1] Locally incorporated commercial banks consist of private banks majority owned by Thais, foreigners, and stated-owned banks.

Table 1
The Financial Institutions in Thailand in 2003

	Item	Regulator
1	The Bank of Thailand	Ministry of Finance
2	Commercial Banks	Bank of Thailand
3	Foreign Bank branches	
4	Bangkok International Banking Facilities (BIBFs)	
5	Provincial International Banking Facilities (PIBFs)	
6	Finance Companies	Bank of Thailand
7	Finance & Securities Companies	
8	Credit Foncier Companies	
9	The Government Savings Bank	Ministry of Finance/Ban of Thailand
10	The Bank for Agriculture and Agricultural Cooperatives (BAAC)	Ministry of Finance/Ban of Thailand
11	The Government Housing Bank	Ministry of Finance/Ban of Thailand
12	The Export - Import Bank of Thailand (EXIM-Bank)	Ministry of Finance/Ban of Thailand
13	The Industrial Finance Corporations of Thailand (IFCT)	Ministry of Finance/Ban of Thailand
14	The Small Industry Finance Corporation (SIFC)	Ministry of Finance/Ban of Thailand/Ministry of Industry
15	The Small Industry Credit Guarantee Corporation (SICGC)	Ministry of Finance/Ministry of Industry

21	Securities Companies	Securities and Exchang Commission
22	Mutual Fund Management Companies	
23	Life Insurance Companies	Ministry of Commerce
24	Agricultural Cooperatives	The Department of Cooperatives Promotio and the Department of Cooperative Auditing, Ministry of Agriculture and Cooperatives
25	Savings Cooperatives	
26	Provident Fund	Securities and Exchang Commission
27	Social Security Fund	Ministry of Labour and Social Welfare
28	Pawnshops	Ministry of Interior

Source: Bank of Thailand

Brief operations of the four main institutions are given below:

2.1 The Bank of Thailand (BOT)

Initially, all central banking activities were performed by the Thai National Banking Bureau, which was established in 1939. However, these activities were taken over by the central bank, i.e. the Bank of Thailand (BOT) upon its establishment in 1942.

Just like any other central banks, the BOT is responsible in formulating monetary policy, supervising financial institutions to ensure that they are secured and supportive of economic development, acting as banker as well as recommending economic policy to the government, acting as banker to financial institutions, managing the international reserves, and printing and issuing bank notes.

Currently, BOT has four regional branches, which perform central banking activities in their locality. The North Eastern Region Office is located in Khon Kaen, the Southern Region Office is located in Songkhla, and the Northern Region Offices are located in Chiang Mai and Lampang. In addition, BOT has also set up Overseas Representative Offices, which are responsible for gathering and compiling information related to the general economic condition and technical developments abroad for the benefit of international reserve management and banking development. These offices, i.e. The Bank of Thailand New York Representative Office, and The Bank of Thailand London Representative Office, also manage international reserves as assigned by the Head Office and act as coordinator with the central banks in the countries where they are located. Furthermore, they are in charge in the assessment of the financial institutions with which BOT has business operations.

In the area of regional cooperation, BOT is a member of several cooperation groups, such as the SEACEN (South-East Asian Central Banks), the SEANZA (Central Banks of South-East Asia, New Zealand, and Australia), APRACA (Asian and Pacific Regional Agricultural Credit Association) and the EMEAP (Executive Meeting of East Asia and Pacific Central Banks). In addition, the BOT also holds regular bilateral meeting with other central banks in the region, for example, Singapore, Malaysia, Indonesia, Hong Kong, the People's Republic of China, and the Lao's People Democratic Republic.

2.2. Commercial banks

Established under the Commercial Banking Act, the business of commercial banking consists of taking time, saving, and current deposits; issuing certificates of deposit; securing loans domestically and from abroad; lending, buying, and selling of foreign exchanges; and trading bills of exchange and other tradable financial securities. Commercial bank also pertains to various other businesses customarily performed by a commercial bank including funds transfer services. Presently, commercial bank may also apply for additional licenses from BOT in order to expand their scope of business, i.e. to include such items as International Banking Facilities (IBF), information and consultancy services, underwriting sales of government and state enterprise securities, managing mutual funds, and acting as debt-collection agent, etc.

2.3. Specialized Banks

Specialized banks are government-owned banks established under specific legislation. Their objectives are to provide financial services to their target customer groups. Currently, there are four different specialized banks operating in Thailand.

a) *Government Savings bank (GSB)*

GSB was established in 1913 with the objective of mobilizing small savings. The bank is owned and operated by the government. It has an extensive network of branches and mobile units both on land and along waterways accepting deposits all over the country. Funds are mobilized from the public in the form of time, call, current, and endowment deposit, as well as GSB lottery. In 1992, GSB had 524 branches, including 20 new branches and 11 mobile units that were opened in that year. To complement its financial activities, ATM facility was introduced by GSB in 1996.

b) *Bank for Agriculture and Agricultural Cooperatives (BAAC)*

The Bank for Agriculture and Agricultural Cooperatives was established under the Bank for Agriculture and Agricultural Cooperatives Act, B.E. 2505 (1966), by taking over the assets and liabilities of the Bank for Cooperatives, which had been in existence since 1947. The Bank's main function is to provide credit to the agricultural sector. In line with this, the BAAC is empowered to provide favorable terms of assistance to promote the livelihoods and economic activities of farmers, farmer's group, and agricultural cooperatives. The main sources of funds of BAAC derive from deposit facilities, bond insurance, foreign and domestic borrowing, and securing BOT loans.

c) *Government Housing Bank (GHB)*

The Government Housing Bank was set up in 1953 under the Government Housing Bank Act, B.E. 2496(1953). It is wholly owned by the government and is under the supervision and control of the Ministry of Finance. The GHB primarily provides long-term loans at low interest rate to assist low and middle income groups in purchasing houses.

d) *Export-Import Bank of Thailand (EXIM)*

EXIM was established in 1994 with the principal objective of providing financial support for international trade and foreign investment. To complement its financial role, the bank offers direct loans, guarantees loans, insures exports, or provides other financial services. In addition, EXIM provides advice regarding import/export-related matters to Thai businesses. The principal source of funds comprise of domestic and foreign borrowings as well as the issuance of debt instrument.

2.4. Finance, Finance and Securities, and Credit Foncier Companies

Authorized by the Acts on the Undertaking of Finance Business, Securities Business, and Credit Foncier Business of 1979, this group of financial institutions normally raises capitals from the issuance of promissory notes. These financial institutions also issue bills of exchange and certificates of deposit. Finance businesses are under the supervision of the BOT, while securities businesses come under the supervision of the Securities and Exchange Commissions (SEC).

Commercial banks are the largest institutions in mobilizing funds in Thailand. As at the end of 2002, total assets of commercial banks in Thailand stood at 6,466,151 million baht while total deposits and total credits amounted to 5,188,321 million baht and 4,623,331 million baht respectively. Initially, there was no specific law governing commercial banking business in Thailand. The only requirement to set up a bank in Thailand is the Royal Charter, which was granted through the Minister of Agriculture. Moreover, there was no tight supervision imposed by the government on the activities of the commercial banks. The first piece of legislation governing the commercial banking business was the Act Regulating Commercial Activities Affecting the Safety and Welfare of the Public B.E. 2471(1928), enacted on 13 October 1928 (Bank of Thailand; 1992).

Commercial banks were further regulated by the Bank of Thailand under the Commercial Banking Act B.E. 2505 (1962) which was revised in 1979, 1992, 1997, and 1998; and B.E. 2522(1979), amended by the Emergency Decree B.E. 2528 (1985). The Bank of Thailand is responsible in prescribing maximum interest rates on deposits and loans, the reserve ratio, the ratio of capital funds to risk assets, etc. In line with financial liberalization, as of March 1992 Bank of Thailand no longer fixed interest rate ceiling on all types of time deposits (Montes, Reyes & Somsak; 1995).

During the past few years, commercial banks' scope of business have expanded from traditional banking businesses to include providing information and financial consulting services as well as feasibility studies; operating as selling agent for debt instruments issued by the Government or state enterprises; undertaking mutual fund management, arranging, underwriting and dealing in debt securities; and operating as securities registrar and representative of secured debenture holder (Economics Research Department; 1998).

3. The Development of Islamic Banking System in Thailand

The history of Islamic financial system in Thailand started with the establishment of a cooperative society, Pattani Islamic Saving Cooperative, that operates based on Shariah in 1987. By the end of 2001, four other Islamic saving cooperatives were established in Southern Thailand, i.e. Ibnu Affan Saving Cooperative (Pattani), As-Siddiq Saving Cooperative (Songkla), Saqaffah Islam Saving Cooperative (Krabi), and Al-Islamiah Saving Cooperative (Phuket). These Islamic cooperative societies have successfully established

themselves as viable financial institutions in managing and mobilizing Muslims funds in this region. For example, total assets for Pattani Islamic Saving Cooperative at the end of 2001 were 90 million baht, while total assets for the Ibnu Affan Islamic Saving Cooperative were 60 million baht as at the end of 2002.

The Islamic banking products and services were first introduced to Muslims in Thailand with the implementation of "Islamic Window" by GSB in 1998. A similar concept was also introduced by BAAC in 1999. The Krung Thai Bank is the first bank to set-up an 'Islamic Branch' in 2001. This branch offers a full range of basic banking products and services based on Islamic principles.

Another key milestone for Islamic banking in Thailand was the enactment of the Islamic Bank of Thailand Act 2002. This law paved the way for the establishment of the first full-pledge Islamic bank, Islamic Bank of Thailand in 2003. This bank, which is located in Bangkok plans to open branches in Yala, Pattani, Narathiwat and Songkla.

3.1. Prospects and Challenges

It is expected that Islamic financial institutions in Thailand are able to provide banking products and services not only to Muslims but also to non-Muslim customers. It is the hope of the government that by allowing Islamic banks to operate in Thailand, they would be able to fulfill the following objectives (Division of Financial Policy and Financial Institution; 2001):

a) To meet the banking and credit needs of the Muslim population in Thailand in conformity with Shariah

b) To cultivate savings habit among the Thai Muslims, particularly for pilgrimage purposes.

c) To supply low cost funds for entrepreneurs who wish to undertake investment projects especially in the southern border provinces.

d) To attract savings and investments from other Muslim countries.

e) To encourage non-Islamic financial institutions to participate in the Islamic banking sector.

Just like many Islamic banks in other countries, the future of Islamic banking in Thailand is very much depended on the Muslim individuals and Islamic organizations. Supports from institutions such as Islamic private schools, mosques, Islamic centers, *zakat* funds and Islamic saving cooperatives are vital especially at the growth stage of these banks. Currently, there are about 128 Islamic private schools with 69,412 students operating in the five southern border provinces (Office of Educational; 1999). Similarly, there are more than 3,018 mosques and 33 Islamic committee provinces out of the 74 provinces in Thailand. These statistics serve as an indicator that there is potential for Islamic banking in Thailand.

The programme to develop Southern Provinces as a hub for *Halal* (permitted) foods as outlined in the government Master Plan creates opportunities for Islamic banks. The banks can participate in the programme by providing capital to entrepreneurs under the principles of *mudharabah* (trust financing) and *musyarakah* (joint-venture).

However, Islamic banking system in Thailand faces several challenges. Among the challenges are (1) economic potential (2) public acceptance, (3) rules and regulations, and (4) human resource

a) Economic Potential

The majorities of the Muslims population in Thailand live in rural areas and are engaged mainly in agricultural activities. These Thai Muslims are amongst the poorest community in the southern provinces of Thailand. Table 3 shows the rate of poverty in these provinces. Narathiwat has the highest poverty rate, followed by Pattani and Yala.

Table 3
The Rate of Poverty in 1998

Province	Total Population	Number of Population Be Poverty Lin
Songkla	1,289,508	20,992
Pattani	598,636	124,200
Yala	402,889	152,777
Narathiwat	641,489	292,451

Source: The National Committee of Social and Economic Office, 1998.

As indicated in Table 3, these provinces have high poverty rate. Furthermore, provinces in the Southern Region have low Gross Provincial Product and income per capita compared to the whole of Thailand (as shown in Table 4). Therefore, this poses a challenge to Islamic banks as they will face difficulties in attracting local deposits. As a result, banks might have to attract deposits from other localities to finance business activities in these provinces.

Table 4
Gross Provincial Product at Current Market Price and Income per capita in 2000

Province	GPP (million baht)
Naratiwat	20,863
Pattani	29,645
Yala	18,462
Songkla	81,883
Satun	16,721
Southern	***448,754***
Country	***4,904,731***

Source: National Statistical Office, 2000.

b) Public Acceptance

In 1998, the Division of Monetary Policy and Financial Institution, Ministry of Finance conducted a survey to investigate the acceptability of people towards the establishment of Islamic banks in Thailand. From a total sample of 452 respondents, 50 percent of them were graduates with an average income between 10,000 to 20,000 baht per month. The survey showed that 98 percent of the respondents favored the establishment of an Islamic bank and were willing to become its customer. They also opined that this bank should come under the government's jurisdiction and have its own sets of regulation.

Table 5 indicates public acceptance towards the existing Islamic banking products provided by GSB and BAAC. There are three types of deposit facilities offered by GSB, i.e. *wadiah* account, Pilgrim savings account, and *mudarabah* account. BAAC on the other hand, provides *wadiah* and *mudharabah* facilities. As shown in Table 5, the most well received account amongst Islamic banks customers is wadiah. For example, *wadiah* facility constitutes 81% of the total deposits at GSB and 94% for BAAC.

Table 5
Composition of Deposits of GSB and BAAC as at the end of 2002

('000 baht)

Types of A/C	GSB	%	BA
Wadiah	108,990	81	86,8
Pilgrim Saving	2,056	2	
Mudarabah	22,916	17	5,1
Total	133,962	100	91,9

c) Rules and Regulations

Currently, two bodies regulate the financial institutions in Thailand, The Ministry of Finance and The Bank of Thailand (the central bank). With regard to the existing institutions, which offer Islamic banking products and services, they are regulated by two different authorities. For example, both GSB and BAAC are under the supervision of the Ministry of Finance through the Government Savings Bank Act, B.E. 2489 (1946) and The Bank for Agriculture and Agricultural Cooperatives Act, B.E.2509 (1966). However, Krung Thai Bank, which was established under the Commercial Banking Act B.E. 2505 (1962), is within the ambit of the Bank of Thailand.

Since the Islamic banking system in Thailand is at it's the initial stage, there is a need to have a legal structure that ensures the followings:

a) A sound and reliable banking system
b) An avenue for Islamic banks to compete freely with conventional institutions
c) An avenue for Islamic banks to invest their excess funds
d) A mechanism which protects both Islamic banks and its customers

In Thailand, Islamic banks are governed under the Islamic Bank of Thailand Act 2002, which comes under the jurisdiction of the Ministry of Finance. Since BOT is responsible for monetary policy and regulating commercial banks in Thailand, BOT is in a better position to supervise the operations and activities of Islamic banks. Hence, it is recommended that the falls within the ambit of this central bank.

Moreover, only Islamic banks fall under Islamic Bank of Thailand Act 2002. It is further recommended that the Act should also govern other banks that provide facilities under the Islamic window concept.

d) Human Resource

Since its inception, GSB has successfully offered Islamic financial services through its 7 branches operating in 6 provinces. Amongst the services provided by GSB includes special counters dealing with Islamic banking products, which are manned by Muslim staffs; and safety box facilities. Similarly, KTB has also employed Muslim staffs in all its 7 branches situated in 7 different provinces. In addition to basic Islamic banking products, BAAC has introduced Islamic Mutual Funds in 45 of its branches located in 14 provinces throughout Thailand.

As Islamic banking is a new concept in Thailand, particularly to bankers, there is a need to educate both the public and policy makers on the Islamic principles of banking. So far, no institutions have been set up in Thailand to provide education in this area. There is also no special division in the BOT to handle matters pertaining to Islamic banking. As a start, cooperation between the Thai authorities and relevant institutions in Malaysia that offers education on the principles of Islamic banking should be established. A division or department that specializes in the issues of Islamic banking should also be set up by the BOT so as to ensure continues growth of Islamic banks as a vibrant financial institution in Thailand.

4. Concluding Remarks

The key milestone to the development of an Islamic banking system in Thailand was the introduction of an ‘Islamic window’ concept by the Government Savings Bank in 1998, followed by the Bank for Agriculture and Agricultural Cooperatives in 1999. The introduction of ‘Islamic Branch’ by Krung Thai Bank in 2001 and the establishment of the Islamic Bank of Thailand in 2003 paved the way for a vibrant Islamic banking system in the country.

This paper discusses the various challenges faced by the Islamic banking system in Thailand. The challenges highlighted in this paper are economic region, public acceptance, rules and regulations and human resource. Amidst such challenges, prospects for this new system as an alternative to the existing conventional banking system remains. Since Muslims make up the majority in the Southern Region, there is a strong possibility that Islamic banks in Thailand will emerge as major financial institutions in the future. To ensure their success, the management of these banks must be customer oriented, innovative, creative, and susceptible to any possible changes in the market.

The government must also play an important role in providing a conducive environment for the Islamic banks to operate. Appropriate rules and regulations must be introduced to protect both banks and customers. As a new market player, Islamic bank faces limited investment opportunities. One of the measures can be taken by government to overcome this limitation is through the issuance of Islamic bonds and bills. Lastly, cooperation amongst Muslim countries, especially Malaysia is paramount in assisting Thailand to develop a more comprehensive Islamic banking system.

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